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**Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

**JOINT COMMENTS OF BELL ATLANTIC,
THE NYNEX TELEPHONE COMPANIES,
AND THE PACIFIC COMPANIES
<u>IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING</u>**

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AND THE PACIFIC COMPANIES[3]
IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING

1. Introduction and Summary

The Commission's guiding principle in this proceeding should be regulatory parity between the rapidly converging and increasingly competitive cable and telephone industries. Equivalent treatment is essential to ensure that the most efficient firms, rather than those with artificial regulatory advantages, prevail in the marketplace.

The Commission has already determined to use competitive benchmarks and price caps as the primary means of regulating cable rates. The issues in this proceeding concern

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[1] The Bell Atlantic telephone companies ("Bell Atlantic") are The Bell Telephone Company of Pennsylvania, the four Chesapeake and Potomac telephone companies, The Diamond State Telephone Company, and New Jersey Bell Telephone Company.

[2] The NYNEX Telephone Companies include New England Telephone and Telegraph Company and New York Telephone Company.

[3] The Pacific Companies are Pacific Telesis Group, Pacific Bell, and Nevada Bell.

the contours of a backup cost-of-service mechanism, available to those cable operators that seek to justify initial rates in excess of the benchmark, and several key aspects of the price cap mechanism for cable.

The Commission should resolve those issues by drawing upon its long experience in regulating the telephone industry. Using its telco rules as a model will reduce the risk of regulatory disparities that may unfairly favor one of these competing industries over the other. In addition, establishing a parallel regulatory structure will further important goals of administrative convenience. There is no reason for the Commission to undertake the needless burden of constructing and administering -- in tandem with numerous local franchising authorities -- a conflicting set of standards to deal with fundamentally indistinguishable regulatory issues already addressed in an established set of Commission rules governing a competing industry.

We believe that many of the rules that currently apply to telephone companies are outmoded and should be streamlined or eliminated. Nonetheless, so long as the Commission believes that it must pervasively regulate telephone companies, these considerations, reinforced by the Congressional policy underlying the 1992 Cable Act, support the adoption of rules for cable that closely resemble the rules for telephone companies.

First, the Commission must prevent monopoly cable operators from using revenues derived from captive subscribers to subsidize ventures in other areas. That is a central requirement of the 1992 Act, which seeks to eradicate the exercise of market power by cable operators. To achieve that goal, the Commission should impose cost-allocation and affiliate-transaction rules for cable that correspond to those applicable to telephone companies. In addition, to facilitate meaningful coordination among federal and local regulators, the Commission should adopt a uniform accounting system for cable similar to the system that governs telcos.

Second, the Commission should apply to cable the same cost-of-service standards that it has traditionally applied to telephone companies. Cable operators should be allowed to recover no more than their reasonable expenses incurred in providing regulated cable service, plus a fair return on their investment. In particular:

- Given the increasing similarity of the technologies deployed by the two industries, cable's depreciation rates should be no different from those applicable to telcos.

- Cable ratebase, like telco ratebase, should be limited to the net original construction cost of assets used to provide the regulated cable service. Excess acquisition costs -- which reflect premiums paid in anticipation of monopoly rents -- must be excluded from ratebase to avoid locking into regulated cable rates the abuse of market power that Congress specifically sought to eliminate.

- Cable's allowable rate of return should be calculated according to the same principles that apply to telcos. The Commission should determine cable's average cost of capital by using its actual cost of debt and actual capital structure. It should determine cable's average cost of equity by reference to a suitable surrogate with equivalent risk, such as the third quartile of the S&P Industrials.

Third, so long as telephone companies are subject to a productivity offset and sharing obligations, cable's price caps should include the same features to avoid bestowing an unwarranted competitive advantage on the cable industry. To obviate annual cost-of-service proceedings for cable operators, moreover, the Commission should apply price caps on a going-forward basis once a cable operator has justified an initial rate in excess of the competitive benchmark. That will streamline rate regulation for cost-of-service operators and will minimize administrative burdens for cable providers, for the Commission, and for local franchising authorities.

2. The Commission's Regulations Must Ensure Regulatory Parity Between the Cable and Telephone Industries

The cable and telephone industries are rapidly converging. Both are deploying the same advanced fiber optic technologies, which add capacity, improve quality and reliability, and permit the carriage of both voice and data traffic. By cable's own estimates, its use of fiber has risen 400% since 1988 and will continue to increase by at least 25%

annually through the 1990's.[4] The growing reliance on fiber in both industries "is blurring the lines, and increasing the competition between them."[5]

Cable already is moving extensively into traditional telephone services, including competitive access and cellular services, and it is active in PCS.[6] Moreover, the cable industry is now forging alliances in preparation for direct, head-to-head competition with local telephone companies. For example, Time Warner Communications and US West recently announced a deal, described as "the first cooperative effort between a phone company and a cable television concern," under which US West will have "the right to use Time Warner coaxial cable and fiberoptics networks to connect long distance

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[4] Department of Commerce, 1993 U.S. Industrial Outlook at 29-12 (Jan. 1993) (relying on NCTA estimates); see also id. (cable industry plans "call for spending $18 billion during the next 10 years to upgrade"); Fiber and Compression to Boost TCI Spending $300 Million Per Year, Communications Daily at 1-2 (Jan. 13, 1993) (TCI to make "bidirectional" fiber systems available to 90% of subscribers within four years); Brown, Operators Plan Growth Along Fiber Lines, Broadcasting at 29 (Feb. 1, 1993) ("[t]hree out of four cable operators say they plan to expand channel capacity, and most of them intend to do so through fiber optic technology").

[5] Department of Commerce, 1993 U.S. Industrial Outlook at 29-12.

[6] E.g., Farhi, Time Warner Plans 2-Way Cable System, Washington Post at F1 (Jan. 27, 1993) (announcing plans to build a cable system offering "telecommunications services"); Huber, Kellogg, and Thorne, The Geodesic Network II: 1993 Report on Competition in the Telephone Industry at 2.53-2.67 (1992) (cable now controls over 50 percent of competitive access provider revenues); Dawson, In Teleport's Shadow, Cablevision at 31 (Sept. 21, 1992) (identifying cable operators' telephone ventures); Gilder, Cable's Secret Weapon, Forbes at 80 (Apr. 13, 1992) ("[t]he cable industry is now moving fast toward two-way capabilities").

carriers, thereby bypassing . . . New York Telephone [the LEC in the relevant area]."[7]

Given this increasing convergence, the Commission must ensure that its regulations provide even-handed treatment of cable and telephone companies. Parity in regulatory treatment is essential to avoid artificially favoring one industry over the other. We have supported in other contexts prudent and sensible reductions in some of the regulatory burdens that currently constrain the local telephone industry. So long as the Commission pervasively regulates telcos, however, it must impose equivalent requirements on cable in order to guarantee that market forces, not uneven government regulations, dictate the competitive outcome.

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[7] Fabrikant, US West Will Buy Into Time Warner, New York Times at A1 (May 17, 1993). US West will invest $2.5 billion in Time Warner. Time Warner already has interests in Fibernet, Inc., and Indiana Digital Access, Inc. (both of which are competitive access providers); plans to establish two CAPS in Manhattan; has created a new unit -- Time Warner Telecommunications -- dedicated to exploring wireless telecommunications opportunities; has obtained PCN licenses in New York, St. Petersburg, Cincinnati, and Columbus; and is undertaking a technical trial of switched phone services in Queens, New York. See The Veronis, Suhler and Associated Communications Industry Report, Financial Performance Review at 77-80 (Nov. 1992); Huber, Kellogg, and Thorne, supra, at 2.61, 2.65, 2.67; Karpinski, Time Warner, MCI Test CATV Bypass, Telephony at 6 (Dec. 7, 1992).

Other cable-telco alliances are similarly positioned to provide competition for local telephone services. In recent testimony before the Vermont Public Service Board, the Vice President of Hyperion Telecommunications of Vermont acknowledged that Hyperion's parent company, Adelphia, also owns two cable companies in Vermont, that Hyperion will use cable company facilities to provide telephone service, and that Hyperion is financed by and will continue to receive financial backing from Adelphia. Testimony of Randolph Fowler, Application of Hyperion for Certificate of Public Convenience, Dkt. No. 5608 (Vt. Pub. Serv. Bd. Nov. 12, 1992).

Because it has been subject neither to competition nor to regulation, cable so far has been free to fund its move into telephony with revenues from captive cable subscribers.[8] The Commission should not perpetuate cable's current unfair advantage through regulations that provide it with more lenient regulatory treatment than telcos. Nor would it be in the public interest for the Commission to implement a regulatory scheme that continues to benefit cable's telephone subscribers at the expense of its cable subscribers.

Although cable argues that the 1992 Cable Act prohibits regulatory parity, the opposite is true. A principal objective of the Act is to foster meaningful competition so that the marketplace can be relied upon to stimulate video diversity and to discipline cable rates.[9] Congress recognized that such competition might come from "other video distribution

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[8] In some instances, cable operators have offered discounted or even <u>free</u> telephone service to subscribers of their cable services -- a clear indication that cable is funding its telephone ventures with monopoly cable revenues. New York Telephone Company, for example, recently lost a bid to Cablevision Systems/AT&T to provide telephone service to Long Island University. LIU required, among other things, cable television service, data connections, and telephone service to all dorm rooms. Cablevision Systems/AT&T offered free campus and local telephone service for the dorm rooms, and offered a per line charge for telephone service that was two-thirds of that in New York Telephone's bid.

[9] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, § 2(b)(1)-(2), 106 Stat. 1460 (1992). Congress sought to "protect consumers by preventing unreasonable rates, by improving the cable industry's customer service practices, and by sparking the development of a competitive marketplace." H.R. Rep. No. 628, 102d Cong., 2d Sess. 26 (1992) ("House Report").

media,"[10] and a "principal goal of [the Act] is to encourage competition from alternative and new technologies."[11] If the Commission applies more favorable regulatory standards to cable than to telcos, it will undermine Congress's intent by giving cable an unwarranted competitive advantage, thereby interfering with the development of a genuinely competitive video marketplace.

Cable relies on a snippet of legislative history suggesting that the House Committee did not want the Commission to "replicate Title II regulation" for the cable industry.[12] But the House Committee's objective was to avoid the imposition of needless regulatory burdens,[13] not to sanction a preferential scheme favoring one competitor over another.

As the Commission correctly recognized, its "overall regulatory scheme fulfills [the Congressional] expectation."[14] First, the Commission's primary reliance on benchmarks and price caps dramatically simplifies rate regulation for cable. No cable operator must undertake a cost-of-service showing --

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10 1992 Cable Act § 2(b)(1).

11 House Report at 27. See also H. Conf. Rep. No. 862, 102d Cong., 2d Sess. 93 (1992) (directing the Commission to adopt rules to "encourage arrangements which promote the development of new technologies providing facilities-based competition to cable").

12 House Report at 83.

13 Id.

14 Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 93-215, Notice of Proposed Rulemaking, at ¶ 15 n.16 (released July 16, 1993) ("NPRM").

the cost-of-service regulations serve exclusively as a backup safety valve for those operators who choose to invoke it for their own benefit.

Second, even for those who opt to make a cost-of-service showing, the regulatory requirements are dramatically simplified. After an initial cost-based rate has been determined, the imposition of price caps will make subsequent full-scale cost-of-service showings unnecessary.

Third, the statute plainly contemplates that the Commission's regulations will take into account traditional cost-of-service considerations.[15] Certainly nothing in the Act or the legislative history requires the Commission to blind itself to the lessons learned during decades of cost-of-service regulation of the telephone industry.

In sum, there is no statutory or policy justification for adopting cost-of-service standards that would give cable an artificial competitive advantage over telcos. Particularly in light of the governing Congressional policy to encourage meaningful competition, it would be arbitrary and capricious to regulate these increasingly competitive industries in dissimilar fashion. The Commission's regulation of cable should scrupulously track the principles by which it regulates telcos in the absence of compelling reasons for specific departures.

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[15] See 1992 Cable Act § 3(a), adopting new § 623(b)(2)(C)(ii)-(vii) (to be codified as 47 U.S.C. § 543(b)(2)(C)(ii)-(vii)).

3. **Cable Should Be Subject to Price Caps That Include a Productivity Factor and a Sharing Obligation**

The Commission has wisely determined to rely on price caps as the primary mechanism for regulating cable rates. As the Commission itself has recognized, applying price caps to cable in the absence of competition has many advantages over traditional regulation from the standpoint of consumers, cable operators, and regulators alike.[16] Significantly, these advantages include the fact that price cap regulation will drastically reduce, both for regulated companies and for regulators, the administrative burdens associated with traditional rate-of-return regulation.

For most cable operators, initial rates will be determined by reference to the Commission's competitive benchmarks for the basic service and programming tiers. For those cable operators who seek rates above the competitive benchmark, by contrast, initial rates will be established through cost-of-service proceedings. Contrary to the Commission's assumption,[17] however, there is no need to require local franchising authorities to conduct frequent cost-of-service proceedings for that group of cable operators. A properly structured price cap mechanism will automatically adjust an operator's initial rate level on a continuing basis

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[16] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Report and Order and Further Notice of Proposed Rulemaking, at ¶¶ 227-29 (released May 3, 1993).

[17] NPRM ¶ 17.

and will obviate subsequent cost-of-service proceedings. Price caps themselves are thus the best assurance that cost-of-service cable operators, like benchmark operators, will be subject to "streamlined" rate regulation.[18]

To avoid conferring an artificial competitive advantage on cable, however, the Commission must ensure that its price cap mechanism for cable operators parallels that for telcos. In particular, until the Commission is prepared to reconsider its rationale for imposing a productivity offset and a sharing obligation on telcos, its price caps for cable should include the same features.

a. **Cable should be subject to a productivity offset to the same extent as telcos.**

Cable is at least as likely as the telephone industry to experience efficiency gains. As explained in the accompanying Affidavit of Robert L. Townsend, cable will have opportunities to improve productivity rapidly as it increases its penetration rates and realizes the resulting economies of scale, as it aggressively replaces coaxial cable with fiber optics, and as it deploys compression technology that dramatically expands the capacity of existing networks.[19]

A productivity offset will ensure that improvements in cable's productivity will be accompanied by the same rate relief to consumers that occurs in the telephone industry. Were it otherwise, cable would have a potent and unjustified

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[18] See NPRM ¶¶ 70-75.

[19] Affidavit of Robert L. Townsend ¶¶ 3-16.

competitive edge over telcos. Cable's productivity offset should replicate the adjustment currently applicable to most telcos. As the Commission correctly observed, an equivalent productivity offset is necessary to "harmonize incentives for converging technologies,"[20] a critically important objective given the increasing competition between the two industries.

There is no substance to cable's suggestion[21] that telephone companies have embedded inefficiencies that do not exist for cable. First, telcos have been subject to price cap regulation with a productivity offset for the past three years; and unlike cable, which still has little competition, telcos face rapidly increasing competition from cable and other sources.[22] The net effect is that telephone companies have worked with intensity in recent years to eliminate inefficiencies, as evidenced most visibly by the industry's pattern of large-scale personnel reductions.

Second, cable does not remotely resemble the engine of competitive efficiency that it represents itself to be. Unlike the telephone industry, cable has been subject (since 1984) to neither competition nor regulation. It is an unregulated monopoly that has faced no meaningful restraints on

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[20] NPRM ¶ 85 n.99.

[21] See NPRM ¶ 85 n.100.

[22] As the Commission has noted, "the telecommunications environment that LECs face has changed radically since the mid-1960s." Policy and Rules for Dominant Carriers, 5 FCC Rcd 6786, 6790, ¶ 28 (1990) ("Price Cap Order"). The current environment is one of "increased competition for a wide variety of telecommunications goods and services." Id. ¶ 27.

its prices and no prods to improve its efficiency. The Commission's justification for a telco productivity offset thus applies with far greater force to the cable industry.

b. **As long as the telephone industry is subject to a sharing obligation and monitoring mechanisms, equivalent rules should apply to cable.**

A pure price cap regime would provide efficiency incentives and would spur the deployment of advanced technologies and the development of new services. Under the Commission's current regulatory framework, however, the telephone industry is subject to a sharing obligation.[23] With the telephone and cable industries using similar technologies and offering competitive services, telcos will be at a severe competitive disadvantage if they must operate under a sharing mechanism from which cable is exempt. Until the rules for telephone companies are modified, cable should be subject to a sharing obligation equivalent to that for telcos.[24]

For the same reason, the Commission should establish monitoring mechanisms for cable operators that match those currently applicable to telcos. That will permit the Commission and local franchising authorities to track cable's performance and assure themselves that cable operators properly comply with their sharing obligation. Moreover, at least so long as telcos are subject to such monitoring under a price cap

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23 See Price Cap Order ¶¶ 120-29.

24 Of course, to the extent that telcos are permitted to operate under a pure price cap with no sharing obligation, that would then be an appropriate mechanism for cable as well.

regime, applying a parallel regime to cable ensures that the two industries are competing on even terms.

4. Cable Should Be Subject to Accounting, Cost-Allocation, and Affiliate-Transaction Rules Equivalent to Those Applicable to Telcos

To preserve regulatory neutrality, and to further economic efficiency, the Commission should apply to cable the same basic accounting, cost-allocation, and affiliate-transaction rules that govern telcos. As Dr. Emmerson explains in his accompanying affidavit, symmetrical rules will "promote competition, economic efficiency, and the optimal rate of technology deployment and the development of new products and services."[25] They will also help ensure that cable operators do not use revenues from their regulated cable services to subsidize their ventures in other areas such as telephony.[26] The Commission has recognized that the rules as applied to telcos provide abundant protection to consumers and competitors alike; the same protections should be provided to consumers and competitors of the cable industry.

Equivalent rules will also promote administrative efficiency and simplicity, alleviating some of the burdens that may otherwise fall on the Commission, on local regulators, and on the cable industry itself. The Commission need not and should not undertake the needless task of recreating regulatory solutions to issues that it has already addressed for the

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25 Affidavit of Richard D. Emmerson at 1.

26 Id. at 1-2.

telephone industry in rules that have been tested in practice.[27]

a. The need for a uniform system of accounts for cable equivalent to that for telcos is particularly acute. Cable offers basic tier, programming, subscriber equipment, local telephony, and a range of other telecommunications services. Some services are regulated, some are not; some are regulated at the federal level, some by local authorities; and some services are regulated under slightly different standards. State and federal regulators will be unable to coordinate their activities effectively unless cable is subject to uniform accounting rules that apply identically to each of these services.[28] Likewise, a uniform system of accounts, together with annual audit requirements like those that apply to telcos, will equip regulators to enforce appropriate cost-allocation and affiliate-transaction rules for cable.

b. Cost-allocation rules for cable, no less than for telcos, will guard against cross-subsidy of cable's various other ventures by regulated cable services.[29] This is a

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[27] For the reasons discussed above (pp. 7-9), the application of competitively neutral rules does not run afoul of Congress's admonition to avoid a wholesale application of common-carrier regulation to cable.

[28] Just as for telcos, a uniform system of accounts for cable will provide a "consistency and stability in financial reporting" sufficient to permit "both management and regulators to assess [relevant financial] results." 47 C.F.R. § 32.1 (1993).

[29] See, e.g., Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, 2 FCC Rcd 1298, 1303, ¶ 33 (1987).

particularly important goal to prevent cable from funding its ventures into telephony by shifting the costs of these services onto its captive cable subscribers. Such cross-subsidization is an abuse of the market power that Congress sought to eliminate in the 1992 Act. In the long run, it also interferes with the normal functioning of market forces in the competition for telephone services, because it allows less efficient firms, supported by revenues generated in their monopoly cable operations, to siphon business away from more efficient telephone competitors.[30]

Telephone companies are already subject to comprehensive rules governing the appropriate allocation of costs between regulated and unregulated services and among different regulatory jurisdictions.[31] The Commission also has in place well-established standards for the allocation of costs

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[30] See Emmerson Aff. at 2-3.

[31] See 47 C.F.R. § 64.901; 47 C.F.R. Part 36; see also Computer III Remand Proceedings, 6 FCC Rcd 7571, 7576-77 (1991) ("we have adopted and implemented a comprehensive regulatory framework that provides . . . protection against anticompetitive conduct"; "our existing cost accounting safeguards . . . constitute a realistic and reliable alternative . . . to protect against cross subsidy"). Given the increasingly competitive nature of the local telephone business, moreover, even these existing rules would be unnecessary for telephone companies, particularly if they were permitted to operate under a pure price cap regime.

among telcos' various regulated services.[32] These rules provide abundant protections for consumers and competitors alike. The same rules should apply to cable. That will ensure that cable operators, like telephone companies, allocate the appropriate costs among their various services and regulatory jurisdictions, and it will provide protection against continued exploitation of cable subscribers.

c. Cross-subsidization can result not only from "the misallocation of common costs," but also from "improper intracorporate transfer pricing."[33] With respect to affiliate transactions, the Commission's rules must provide assurance that cable operators, like telephone companies, will not be permitted "to purchase assets at inflated prices [from affiliates] and then recoup the excessive cost through the resulting increase in the cost-based rate of return" or to sell assets to affiliates "at an artificially low price and then let any loss fall ultimately on its ratepayers."[34]

There are numerous opportunities for such abuse in the cable industry. For example, if cable operators were free

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[32] These standards ensure that consumers benefit from reasonable rates while also protecting against predatory pricing of competitive services. See, e.g., Amendment of Part 69 of the Commission's Rules, 6 FCC Rcd 4524, ¶ 42 ("a LEC introducing new services will be required to . . . identify the direct costs of providing the new service"); 7 FCC Rcd 5235, ¶ 1 ("the direct cost showing provides sufficient protection against predatory pricing").

[33] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, 2 FCC Rcd at 1303, ¶ 33.

[34] Southwestern Bell Corp. v. FCC, 896 F.2d 1378, 1380 (D.C. Cir. 1990).

to pay excessive prices to their programming affiliates, they could preserve their existing monopoly profits simply by diverting them upstream to their unregulated programming operations. Likewise, if cable operators could provide local transport capacity to their competitive access affiliates at artificially low prices, captive cable subscribers would be forced to finance the affiliated CAPs' below-cost pricing of local telephone services.[35]

These results are antithetical to the fundamental purposes of the 1992 Act. To guard against such manipulation of interaffiliate transfer pricing, the Commission should apply to cable the same affiliate transaction rules that currently govern telephone companies.[36] Those rules provide that, in the absence of a tariff or a prevailing price for transactions with unrelated third parties, assets purchased from an affiliate must be accounted for at the lower of cost or fair market value, assets sold to an affiliate must be accounted for at the higher of cost or fair market value, and services must be accounted for at fully allocated cost.[37] Identical provisions should be applied to cable.

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35 See Emmerson Aff. at 5.

36 47 C.F.R. § 32.27.

37 47 C.F.R. § 32.27(b), (c), (d).

5. **The Commission Should Adopt for Cable the Same Cost-of-Service Standards That Have Historically Been Applied to Telcos**

As the Commission has correctly stated, in those instances when cable operators themselves elect to go through a cost-of-service proceeding, its rules must allow cable companies to charge rates that "approximate competitive levels, i.e., rates that approach the operators' costs," including the cost of capital.[38] The statute expressly provides that regulated cable rates must not exceed those that would be charged in a competitive market.[39] In a competitive environment, operators would recover their reasonable costs and would earn a fair return on their investment. In order to comply with the Act's directive, the Commission's cable cost-of-service standards should be designed to yield a like result.

Furthermore, rates in excess of cost plus a fair return would give cable an unfair weapon in its competition with telephone companies. Setting cable rates at levels sufficient to cover operating and capital costs will put cable

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[38] NPRM ¶ 10. That standard unquestionably satisfies the governing constitutional requirements. The Fifth Amendment forbids regulators from fixing rates that are "so 'unjust' as to be confiscatory." Duquesne Light Co. v. Barasch, 488 U.S. 299, 307 (1989); accord FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944). Regulated rates pass constitutional muster if they provide "for operating expenses" and "for the capital costs of the business." Id. at 603; Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1176 (D.C. Cir. 1987) (en banc); Tenoco Oil Co. v. Department of Consumer Affairs, 876 F.2d 1013, 1020 (1st Cir. 1989).

[39] New § 623(b)(1), 47 U.S.C. § 543(b)(1).

on a par with telcos[40] and will minimize artificial regulatory preferences that might otherwise skew the markets in which these industries increasingly compete with each other.

The Commission's rules governing cable's expenses, ratebase, and rate of return should closely track the rules that historically have governed telcos. There is no reason for the Commission to reinvent cost-of-service standards that have stood the test of time, and there are sound reasons to avoid introducing regulatory distinctions that could distort the competitive balance between the two industries.

a. The regulatory treatment of cable's expenses should be consistent with the Commission's telco rules.

Just as it has prohibited telcos from recovering unrelated expenses through regulated telephone rates, the Commission must limit cable's recoverable expenses solely to those incurred to provide regulated cable service. Cable consumers must not be asked to foot the bill for the cable industry's ventures in other areas. Indeed, as the Commission correctly recognizes, it would breach its fundamental responsibility to ensure "reasonable" rates were it to permit cable to "impos[e] the costs of nonregulated activities on

[40] The starting point for telco price-cap regulation was the cost-based rate structure that was then in effect. Price Cap Order ¶ 231. The Commission concluded that the telco rates in existence as of July 1, 1990, were "a reasonable starting point for price cap regulation," because they "represent the best that rate of return regulation can produce." Id. ¶¶ 231, 232. Since that time, the price cap rules themselves have ensured that rates are maintained at reasonable levels.

regulated cable subscribers through improper cross-subsidization."[41]

Because cable and telcos are increasingly deploying the same technologies, there is every reason to apply the same depreciation rules to both. If cable operators were able to depreciate assets more quickly than telephone companies, they would obtain an artificial competitive advantage in deploying the advanced technologies that both industries are using to compete with each other.[42] In the long run, cable's ability to depreciate assets on a more accelerated schedule will artificially lower its expenses later in comparison to telcos. In the short run, cable would be free to cover its higher depreciation expenses with increased revenues from captive cable subscribers.

Depreciation rates should therefore be prescribed for cable in the same manner as for telephone companies.[43] Although the Commission has recognized that the telco depreciation rules are outmoded -- and it is considering alternatives to simplify the existing approach[44] -- whatever

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[41] NPRM ¶ 67.

[42] See the accompanying Affidavit of James H. Vander Weide ¶ 36.

[43] Under the telco price cap rules, changes in depreciation rates do not produce a change in service prices. Likewise, changes in depreciation rates for cable assets should be treated as endogenous and should not translate into service price changes.

[44] See Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Notice of Proposed Rulemaking (released Dec. 29, 1992).

rules are applied to telephone companies should apply equally to cable.[45]

b. **The rules for cable ratebase should be the same as for telcos.**

The Commission should permit cable operators to earn a return only on the original construction cost, net of depreciation, of the assets used to provide regulated cable service. That principle should apply both to the original owner of the cable assets and to any subsequent purchaser. Cable ratepayers must not be asked to finance the excess acquisition costs incurred by purchasers willing to pay monopoly premiums for cable properties.

i. The original cost methodology is widely employed by utility regulators.[46] Because it requires consideration only of construction costs _actually_ incurred, which are easily proved, the net original-cost method does not "suffer[] from the practical difficulties" that plague other valuation approaches, such as the market-value, replacement-cost, or reconstruction-cost methods.[47] These other alternatives either involve "the 'laborious and baffling task of finding the

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[45] As long as it does so for telcos, moreover, the Commission should disallow recovery of all cable expenses related to lobbying and other items referred to in 47 C.F.R. § 32.7370. These expenses deserve no different treatment for one industry than for the other.

[46] _See_ _Jersey Central_, 810 F.2d at 1175.

[47] _Duquesne_, 488 U.S. at 309. The market-value method also suffers from a conceptual flaw: in a regulated environment, market value is the _result_ of regulation, not the starting point. Vander Weide Aff. ¶ 27.

present value of the [regulated company]'" or "degenerate[] to proofs about how much it would cost to reconstruct the asset in question, a hopelessly hypothetical, complex, and inexact process."[48]

More important, the Commission applies the net original cost standard to telephone companies.[49] It should apply the same standard to cable to maintain competitive parity between the industries.[50] If cable were able to increase its monopoly rates by adjusting its ratebase above the net original cost of capital devoted to the regulated service, it could effectively earn an inflated return on the plant and would have an unfair advantage over telephone companies. There is no reason to differentiate between the two industries in constructing the ratebase.

ii. The Commission should prohibit cable operators from adding excess acquisition costs to the ratebase. The payment of excess acquisition costs in the cable industry is attributable in large measure to the purchaser's expectation of earning monopoly rents in the future. Congress recognized when it adopted the 1992 Cable Act that the value of cable

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[48] Id. at 309 n.5 (quoting Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Comm'n, 262 U.S. 276, 292 (Brandeis, J., dissenting)). See Vander Weide Aff. ¶ 28.

[49] 47 C.F.R. § 32.2000(b).

[50] See Vander Weide Aff. ¶ 29.